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IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

No. 575.

COLORADO-WYOMING GAS COMPANY, a corporation, *Petitioner*,

v.

FEDERAL POWER COMMISSION; COLORADO INTERSTATE GAS COMPANY, a corporation; CITY & COUNTY OF DENVER, COLORADO; PUBLIC SERVICE COMMISSION OF WYOMING; PUBLIC SERVICE COMPANY OF COLORADO; AND CANADIAN RIVER GAS COMPANY.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Tenth Circuit.

REPLY BRIEF AND ARGUMENT OF PETITIONER.

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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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The brief of the Commission filed herein just prior to oral argument presents several matters which require discussion and clarification. The contention advanced is that "The Natural Gas Act does not prescribe any *method* of allocation. Congress thus left *the matter of allocation* to the expert judgment of the Commission, subject to judicial review in the event of an abuse of its administrative discretion in this regard" (p. 10). From this contention it appears clear that the Commission confuses principle

and method and in so doing dispenses entirely with controlling principle. Having dispensed with controlling principle, there is of course no test or measure of "abuse."

The principle of allocation as declared by this Court is that where the business of a utility embraces oprations, a portion of which is subject to the rate regulatory control of the Commission and a portion of which is not subject to that authority, it is necessary to segregate in some appropriate manner the property and income of the utility not so subject to the rate regulatory control of the Commission from those operations with respect to which the Commission may exercise such control. This is necessary in order that the Commission may not embark upon a rate regulatory control over which it has no authority. True enough, the Natural Gas Act does not prescribe any *method* of allocation. The method or formula of allocation, however, must apply the controlling principle to the required objective. The "method" or "formula" is an application in any given case of the controlling principle. Unless there is a controlling principle, the so-called "method" or "formula" is a total irrelevance.

The principle of allocation measures the quality and reasonableness of the formula. The Commission in effect denies the existence of the principle.

The decisions of this Court in the *Minnesota rate cases*, 230 U. S. 352, and in *Smith* v. *Illinois Bell Telephone Company*, 282 U. S. 183, and *Columbus Gas and Fuel Company* v. *Public Utilities Commission*, 292 U. S. 398, are disposed of on the assertion that the regulation of the interstate wholesale rates of natural gas companies under the Natural Gas Act does not present a constitutional question "since Congress, *if it so desired*, could regulate the intrastate rates of such companies which 'affect' their interstate rates and operations" (p. 11). Whether or not Congress, *if it so desired*, could have regulated the intrastate rates of such companies is immaterial, for in fact Congress, under the Natural Gas Act, *did not attempt to regulate such intrastate rates*. In either event the Commission is equally devoid of jurisdiction.

We are not concerned in this discussion with the precise "method" or "formula," provided the procedure of allocation conforms to and is an application of the principle involved.

It is asserted both by the Commission in its opinion and by counsel in their brief that "All that can be accomplished by allocation of physical properties can be attained by allocating costs, including return" (p. 12). It is clear that upon an allocation of property there results a determination of the proportion of property devoted to and the net income derived from the regulated business and that devoted to and derived from the non-regulated business. *It is a measured and determined amount of both.* The Commission's allocation of costs so-called does not disclose, and it can not be ascertained therefrom, either the proportions of the property devoted to or the net income derived from the regulated and non-regulated business, respectively. And it is not claimed either by Commission or counsel that such ascertainment is made by the Commission's procedure or can be ascertained therefrom. Thus, all that can be accomplished by an allocation of physical properties *cannot* be attained by allocating costs in the manner indulged in by the Commission. The contention of the Commission, therefore, is for an uncontrolled discretion. This is true because it is impossible to ascertain from the Commission "allocation," so-called, whether the property devoted to and income derived from the non-regulated business have been excluded in their entirety from the Commission's order of reduction.

The legal and controlling principle of allocation having been disposed of by *ipse dixit* and by linguistic magic, counsel then undertake to establish the proposition that "The Commission's allocation of costs of service was reasonable and appropriate" (pp. 12-21). It is to be borne in mind that the sole Commission exhibit (R. III, Ex. 227) upon "allocation" so-called was departed from by the Commission in its order (R. I, pp. 79-80, 82-83). The procedure which we are told was followed by the Commission purports to be set forth in *Appendix B, Schedules 1-4 of the Commis-*

sion's brief. Appendix B is very directly in the nature of an exhibit and obviously is appended to the brief in order to make *some* disclosure to this Court as to the Commission's procedure, which is not apparent, either from the record or from the opinion and order of the Commission. The Commission describes the procedure, *method* or *formula* adopted by it as the "demand and commodity" method. The particular "method" in question is one that has been used on occasion in the fixation of rate structures, but not in the application of the controlling principle of allocation to separate regulated and unregulated property and income. As a matter of fact, the method which the Commission's counsel declare the Commission followed was not used in the case referred to (p. 12), and this is evident from the cross-examination of the Commission allocation witness (R. II, pp. 774-779). Such "method" is predicated upon an assumed or hypothetical rate structure, and as applied to the "cost of gas purchased for sale" by petitioner from Colorado Interstate Gas Company does not represent the actual purchases of gas in the year 1939. The so-called "cost of gas purchased" is a synthetic figure, because predicated upon a rate structure of Colorado Interstate Gas Company which is wholly non-existent. It is to be noted that the Commission, in its order against Colorado Interstate Gas Company in Case 379 before this Court, ordered a total reduction in dollars but made no order whatever as to the character of the rate structure of Colorado Interstate Gas Company reflecting such reduction. The order provided that "Colorado Interstate Gas Company shall file * * * new schedules of rates and charges * * * to reflect the reductions ordered * * *." (R. I, p. 93.) The so-called "cost of gas purchased" is reflected in column (4) of Schedule 2 of Appendix B of the brief.

The same Schedule 2, in column (3), declares that on the alleged peak day adopted by the Commission, 1777 out of the total of 10,768 M. c. f., or 16.5 per cent of the total deliveries on that day were deliveries to direct sales customers, that is, the non-regulated business. Deliveries to resale customers, the regulated, are declared to be 9,009

M. c. f., or 83.5 per cent. *The Commission's figures, however, do not represent actual deliveries.* They are purely "estimates and averages," monthly or weekly, applied to the peak day. That the alleged deliveries to direct sales customers were averaged and estimated but not computed is uncontroverted in the record (R. II, pp. 735-736). The petitioner, however, offered in evidence the *actual* deliveries on the alleged peak day adopted by the Commission. The deliveries to resale customers, being the regulated business, were 11,034 M. c. f., or 95.5 per cent of all deliveries. The deliveries to direct sales customers, being the non-regulated business, were 522 M. c. f., or 4.5 per cent of the total (R. I, p. 186). The Commission's witness also testified that he did not know which of the direct sales customers were "curtailed" or "shut off" on that day, or whether or not during the course of the day all direct sales customers were "shut off" (R. II, pp. 731-732, 747). The actual delivery to the non-regulated customers on the assumed peak day being 522 M. c. f., the ratio percentage is 4.5 per cent instead of 16.5. As a consequence the *transmission capacity costs* in column (6) of Schedule 2 of Appendix B apportioned to "sales for resale" are 95.5 per cent instead of 83.5 per cent, thereby increasing such costs of the "sales for resale" almost $21,000 over the figure used by the Commission in that schedule. Such costs being increased by that amount of money, it is noteworthy that the entire net reduction ($21,000) ordered against this petitioner thereby is eliminated. This is not a matter of "discretion." This error of the Commission is shown by uncontroverted testimony.

The purpose of using a so-called "peak day" is to ascertain the relative demands upon the system and its capacity by the preferred regulated "sales for resale" customers as compared with the inferior rights of direct sales customers who are unregulated. The ascertainment of relative demands obviously requires a study of peak day conditions upon the system. This the Commission's only witness for allocation did not make. He did not give consid-

eration to nor did he know the relative demands of the two classes of customers on any other peak day, either in the year 1939 or in any other year (R. II, p. 736). For example, there was during the test year adopted by the Commission, which according to Exhibit 227, Table 2 (R. III), covered the "12 months ending June 30, 1939" a peak day on December 26, 1938, in which the deliveries of this petitioner were about 20 per cent in excess of the deliveries on February 9, 1939 (R. I, p. 186). February 9, 1939, was adopted as the peak day simply because it was the peak day of Colorado Interstate Gas Company, and for no other reason.

The statement of counsel that "The demands of the domestic and commercial consumers were higher on that day than any other in the test year 1939 (R. II, 750-751, 760-761)," is not supported by the record. The Commission allocation witness testified that he made no study of and did not consider the peak demand of domestic customers on any other day than February 9, 1939 (R. II, 736, 751, 760).

In apportioning costs between capacity and volume, it is said by counsel that "The annual return and income taxes on the transmission plant * * * were *considered* 50 per cent volumetric and 50 per cent capacity costs" (pp. 15-16). This distribution of income taxes and return on a 50-50 basis was done without any statement or showing of the reasons therefor, although as appears from Schedule 2 of Appendix B of the brief, the income derived from "sales for resale" was more than twice as much as that derived from direct sales. See also page 20 of Commission brief. In apportioning income taxes and return the ratio of net income from the regulated and the non-regulated business would appear to be the normal distribution as between the capacity costs and the volumetric costs, unless there were particular reasons why some other apportionment of these items should have been adopted. No reason was disclosed. The result is that the Commission's action becomes under such circumstances a finality without possible redress unless the courts examine the basis and propriety of such ap-

portionment. "Judgment" must be reasoned and reasonable, and of course must be predicated upon disclosed facts. The Commission "allocation of costs" procedure is so elastic that "the end result" produced is whatever result is desired by the Commission.

By the natural and logical apportionment of income taxes and return ($102,800—Table 6, Ex. 227, R. III) between volumetric and capacity "costs" on the ratio of the property devoted to and the profits derived from the sale for resale and direct sales operations, respectively, the so-called "costs" of the sales for resale business are increased not less than the $21,000 net reduction ordered as to this Company. See columns (5) and (6), Schedule 2, Appendix B, brief of Commission.

It is sought to dispose of the assumption by the Commission of rate regulatory authority over the *Colorado sales for resale* by reference to the case of *Illinois Natural Gas Company* v. *Central Illinois Public Service Company*, 314 U. S. 498. The inapplicability of that case to the situation here involved we have discussed in our principal brief. However, in order to exercise rate regulatory jurisdiction over *Colorado* "sales for resale" the Commission after treating Colorado-Wyoming Gas Company throughout the case as wholly separate and distinct from Colorado Interstate Gas Company which it is, and which the record shows it to be (R. I, pp. 120-121, 122-123) concluded, *for purposes of allocation* (R. I, p. 79), that Colorado Interstate Gas Company and Colorado-Wyoming Gas Company, and also Canadian River Gas Company, as well, *all* constituted but "a single project." Thus, the petitioner, which is independent in management, in operation, and in control from Colorado Interstate Gas Company, nevertheless is regarded in this respect as a part of that company and for other purposes as not a part of that company. It would appear that this company either is or is not a part of "a single project" extending from Texas to Wyoming. It cannot be both.

cannot be both. This issue is presented directly and specifically in paragraph (1) of "The Seventh Question," counsel to the contrary notwithstanding (p. 9).

Appendix B of the brief is an exhibit which should have been offered in evidence. The terms thereof should have been disclosed long since. It is perfectly obvious that the right of this petitioner to examine the exhibit and to cross-examine the witness or witnesses who prepared it was a valuable right. The denial of that right is a denial of the very elements of procedural due process which the late Mr. Justice Holmes defined as "the rudiments of fair play." To say, as counsel do (p. 20), that Appendix B "was merely a mathematical calculation" flowing from the Commission's statement of procedure in its opinion as applied to Exhibit 227 (R. III) is belied by the facts. That such is not the case is readily ascertainable from an examination of Exhibit 227 and comparison thereof with Appendix B of the brief. More than that, in Appendix B are set forth only totals. How those totals are arrived at in the various columns of cost is not disclosed.

The Commission's "allocation of costs" clearly, therefore, is predicated neither upon principle nor upon the facts of this record and the designation of the Commission's procedure as a "method" or "formula" does not change the evident and compelling fact that that procedure was merely a device.

Respectfully submitted,

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